Shipping Finance

3rd Edition

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Prepared by Stephenson Harwood

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the basics of shipping finance – with chapters on financing new and second hand vessels, standard security documents and sale and purchase – it also looks at the hot topics of the day including IPOs, derivatives and Islamic financing. Probably the most practical chapters are the two dealing with vessel and mortgage registration. Set out in a question and answer format for ease of comparison, these two chapters now contain contributions from both Indian and Chinese lawyers, in addition to updated contributions from lawyers in all major maritime jurisdictions, making this a must have manual for bankers, owners, brokers, lawyers and indeed all those involved in shipping finance.

July 2006

Foreword

Dagfinn Lunde
Chairman and CEO, DVB Bank N.V.

There has been a great deal of change in both the shipping industry and in the shipping finance market since the publication of the second edition of this book some eleven years ago. Although bank debt remains the dominant source of capital in the industry, we have seen a significant increase in alternative capital sources in recent years. Debt and equity from the public markets, the Norwegian KS and German KG systems, tonnage tax schemes and tax lease finance can all now be regarded as commonplace in the shipping finance market. Bank debt structures have also become considerably more complex and the use of financial markets products in shipping finance transactions is now standard.

Freight rates and vessel values across all major shipping sectors have reached unprecedented levels in the last couple of years following a period of relatively depressed activity through the late 1990s and into the early part of the new millennium. A five year old Panamax bulk carrier, for example, could be purchased for US$13.5m and achieve freight rates of US$5,500 per day in 1999 while a similar profile vessel was worth US$46m and achieved freight rates in excess of US$46,000 per day in 2004/2005. This recent period of prosperity has seen the profile of shipping raised and resulted in a successful foray into the public equity markets by a number of owners. It has also raised the awareness of individual investors and shipowners alike to the benefits of tax partnerships and tax leases. More recently we have seen the tax leasing structures give way to new structures based on real economic risk. In most countries this is in the form of the more popular tonnage tax regimes. These regimes offer a favourable outcome when compared with investments made in land-based transportation activities.

The future of shipping continues to see one name at the forefront of all discussions: China. Not only is it significant in world trade, but its significance to the shipping industry as a whole continues to grow apace. The shipbuilding industry is a prime example. China, which accounted for no more than 5 per cent of the shipbuilding industry 2 years ago, now accounts for 19 per cent. This escalates them to third in the ranks of shipbuilding nations behind South Korea and Japan. The momentum shows no sign of abating, with China set to become the number one shipbuilding nation within the next couple of years. At the same time however, Japan and Korea show no sign of conceding capacity to compensate. It is a fair assumption therefore that shipbuilding capacity will be in abundance in the coming years. The ongoing imbalance between supply and demand will therefore continue to contribute to the volatility of the shipping market and continue to provide opportunities to those that are financially and economically aware.

The wide range of topics covered in this text book makes it an invaluable tool for all involved in shipping finance. Written and updated by experts in their fields, each chapter deals with the many issues faced by practitioners on a daily basis. This new edition covers not only

Finally we must repeat the word of warning with which Graham Burns ended the preface to the first and second editions. Any book of this nature can only contain advice in very general terms. Every transaction involves different considerations, both legal and commercial, and no book can be an adequate substitute for taking full and detailed professional advice in each individual situation. We have attempted to state the law at July 2006, unless otherwise indicated.

Lucy French and Jonathan Ward
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London
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July 2006

Preface

Over ten years have passed since the second edition of this book was published and a great deal has happened in the world of ship finance since then. We at Stephenson Harwood have written the third edition in order to ensure that it is still the practical ship finance manual it was designed to be.

The areas covered by the previous edititons of the book have been reviewed. The chapter on environmental issues has been omitted, not because this is no longer relevant, but simply because the Oil Pollution Act of 1990 has been around for some 16 years now and is so much part of shipping that it is no longer the hot topic it was in 1995. Ship finance is a global subject and we have therefore replaced the chapter on UK tax issues (which we felt was unlikely to be of interest to a large number of our readers) with a chapter on Islamic finance – an area of great interest at present.

The last few years have been great years for shipping, with historical highs achieved in the tanker, bulk and liner charter markets. Shipping has also made an impact on Wall Street thanks to the high volume of shipping IPOs, especially since 2004. We are delighted that we are able to include an updated chapter on the US Capital Markets, contributed by an expert in his field, Gary Wolfe, a man who has been involved in some form or another with almost every shipping IPO in recent years.

The shipping industry has become far more regulated in the past decade with the introduction, amongst other things, of the ISM Code in 1993 and the ISPS Code in 2002. The day-to-day impact of these far-reaching regulations can be seen in our updated questionnaire section in the chapter on vessel registration. The list of registries contributing to our chapters on vessel and mortgage registration has been updated to reflect current trends and we are very pleased that we have been able to include two new up-and-coming registries in our questionnaire sections – China and India.

Graham Burns did a wonderful job in editing the first two editions of this book and, indeed, wrote several of the chapters. We have been very fortunate to have such a strong foundation on which to build and for this, we owe Graham a huge debt of gratitude (and forgive him for declining our request to come out of 'retirement' to edit this 2006 edition).

Our thanks also to all the contributors to this third edition – to those lawyers who have provided detailed information on their respective flags and shipbuilding industries, to Doug Garnsey for rewriting the chapter on derivatives in shipping finance and Graham Barnes for updating his chapter on insurances and to Peter Illingworth and Alan Brauner for writing the chapter on the Banker's Perspective. Thanks also to all the other contributors within Stephenson Harwood – not only to those named as such in each chapter but especially to Philippa Sharratt, who helped to edit the various questionnaires, to June Pun who carried out a great deal of painstaking legal research and to Michael Bundock, whose comments and advice on many chapters were invaluable.

List of abbreviations

BIMCO	Baltic and International Maritime Counsel
CEXIM	The Export-Import Bank of China
CIRR	Commercial Interest Reference Rate
COFR	Certificate of Financial Responsibility
Dwt	deadweight
EBITAD	Earnings before Interest, Tax and Depreciation
ECGD	Export Credits Guarantee Department
FFE	forward foreign exchange
FFA	forward freight agreement
FFABA	Forward Freight Agreement Brokers Association
FRA	forward rate agreements
grt	gross registered tonnage
gt	gross tonnage
HSCGS	Home Shipbuilding Credit Guarantee Scheme
IMO	International Maritime Organisation
IOPC Funds	International Oil Pollution Compensation Funds
IPO	Initial Public Offering
IRS	Interest rate swap
ISDA	International Swaps and Derivatives Association
ISM Code	International Safety Management Code
ISPS Code	International Ship and Port Facility Security Code
ITF	International Transport Workers' Federation
KEXIM	The Export-Import Bank of Korea
LIBOR	London Interbank Offered Rate
LMAA	London Maritime Arbitrators' Association
MarAd	US Maritime Administration
MOA	memorandum of agreement
MTM	mark-to-market
MVC	mimimum value covenant
NIS	Norwegian International Ship Register
NOS	Norwegian Options Exchange
nrt	net registered tonnage

of bilateral and syndicated lending and in particular has advised a number of international banks on high profile complex syndicated transactions. Sheila has extensive experience in relation to all types of financing arrangements for new buildings and second hand vessels as well as vessel related project financings. Sheila acts for banks as well as shipowners including first class banks and owners in the Middle East.

Struan Robertson

Struan Robertson has practised in the maritime field for more than thirty years. He is Deputy Chairman of the International Maritime Industries Forum, a member of the Steering Committee of the London Shipping Law Centre and past chairman of the City of London Law Society Sub-Committee on Shipping and Aerospace law. He specialises in sale and purchase, shipbuilding, finance and cross-border leasing and has a particular interest in the C.I.S. and in the Gulf States due largely to an involvement with the tanker industry as a result of some years spent with a leading tanker owner in the Far East.

Mark Russell

Mark Russell is the head of Stephenson Harwood's Banking and Asset Finance Practice Group. He acts for a range of banks and other lending institutions, as well as shipowners and North Sea operators, in a wide variety of ship finance, leasing and sale and purchase matters, and in connection with oil and gas exploration and project financing.

Jonathan Ward

Jonathan Ward is a partner in the Banking and Asset Finance Department of Stephenson Harwood. He specialises in all aspects of ship finance including ship registration, sale and purchase, shipbuilding, structured ship finance and leasing matters, domestic and cross border. Jonathan represents ship finance institutions, lessors, shipowners, shipyards and contractors world-wide. Jonathan is a regular speaker at finance and shipping seminars and has lectured in the UK and abroad.

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Gary J Wolfe is a partner of New York City law firm Seward & Kissel LLP, where he heads that firm's capital markets group. He represents domestic and international clients mainly in securities, corporate and maritime matters. Mr Wolfe graduated from Cornell University and Yale Law School, where he was a founding editor of the Yale Journal of World Public Order. Mr Wolfe has served as President of the US Business Council for South Eastern Europe, Chairman of the Admiralty and Maritime Law Committee of the New York County Lawyers Association and a member of the Admiralty and Maritime Law Committee of the Association of the Bar of the City of New York.

Chapter 1

Introduction

Updated by Lucy French

> *The method of obtaining finance for ships ... may be summarised in these words. The bank advances to one or more owning companies a large sum of money. It of course requires security. It will take a mortgage on the ship for that security. It may take other mortgages on other ships for the same security. If the ship, as often happens, is about to be time chartered, then the bank will take an assignment of the time charter in order that the bank as assignee can benefit from the time charter in order to reduce the mortgage debt. In addition it will ... take an assignment of insurance policies and P and I Club cover in order that in the event of total or partial loss of the ship the bank as the lender may be suitably secured ... The effect of this is to ensure that the lending bank is completely secured against the insolvency of the borrower who intends that the bank shall obtain complete priority over the claims of other creditors against the borrower.*[1]

In general terms then, that is what ship finance and hence this book is all about. The bottom line of any ship finance deal is that a bank or some other lender advances money to a shipowner to assist the owner to build a new ship; buy a second-hand ship; convert, repair or alter a ship; or refinance existing indebtedness secured on a ship. The lender must be secured and looks, for his principal (though by no means only) security, to the ship itself.

Of course, there are many permutations, many refinements, many factors to be taken into account, and the aim of this book is to explore some of them. It is not intended to be a fully comprehensive textbook on shipping or banking. Rather, it is intended to highlight the particular factors that make ship finance different from other types of lending. One general topic not covered in this third edition is tax – not because it is no longer relevant, far from it. A discussion on the tax aspects of shipping finance, to be of any real value, would require an entire book. A single chapter would not do justice to such a huge subject.

Ship finance is no more a fixed science than is any other sort of finance. Financial terms and conditions change – especially in a cyclical industry such as shipping – and banks and owners become ever more sophisticated. Different types of vessel require lenders to take into account different considerations. Ultimately, though, the starting point is the same. The bank lends and the borrower secures the repayment of the loan by mortgaging his ship to the bank. Invariably there will be other security. What and why will be explored later.

The international element

More than most other forms of finance, ship finance is international. A ship is an unusual asset. Most ships move – or are capable of moving – all over the world. The financing of large ocean-going ships is undertaken by banks all over the world, by no means just for owners in

NSF	Norwegian Sale Form
NYMEX	New York Mercantile Exchange
NYSE	New York Stock Exchange
P&I clubs	protection and indemnity clubs
QIB	Qualified Institutional Buyer
SDR	Special Drawing Rights
SEC	Securities and Exchange Commission
SGA	Sale of Goods Act
SMFC	Ship Mortgage Finance Company plc
SOLAS	Safety of Life at Sea
SUECS	Sector Understanding on Export Credits for Ships
UCC	Uniform Commercial Code
US GAAP	US Generally Accepted Accounting Principles
VLCC	very large crude carrier

Article 90 of the 1982 Convention provides that every state has the right to have a merchant fleet under its flag, and vessels in that fleet are entitled to the use of the high seas. Article 91 provides that 'every state shall fix the conditions for the grant of nationality to ships, for the registration of ships in its territory, and for the right to fly its flag. Ships have the nationality of the state whose flag they are entitled to fly. There must be a genuine link between the state and the ship'.'

The 1982 Convention stops there and does not tell us what constitutes a 'genuine link'. The 1986 UN Convention on Conditions for Registration of Ships tries to help by describing the requirement of a genuine link as meaning that nationals of the flag state must participate in the ownership, manning or management of the vessel. This Convention has not yet been signed by a sufficient number of countries to come into force and it is unlikely that it will. Certainly, it has not been signed by many important ship registry jurisdictions.

As anyone with any involvement with the shipping industry will know, this is not how ship registration works in practice.

The different types of registry

Traditionally, a ship owned by a national of a particular country was registered in that country and crewed by nationals of that country. It was subject to the jurisdiction of the authorities of that country, and was liable to requisition by those authorities in time of war. In many countries, the owner had no say in the matter and registration was obligatory. In the United Kingdom, registration of British ships was compulsory from the Navigation Acts of 1660 onwards. Section 2 of the Merchant Shipping Act 1894, which codified the previous law and held sway for over 90 years, made it mandatory for a British ship (subject to certain minor exemptions) to be registered in accordance with the Act. Although not specifically defined in the Act, the term 'British ship' meant, in summary, any ship owned by a British subject or a body corporate established under the laws of some part of Her Majesty's dominions, with a principal place of business in those dominions.

Only in 1989, with the coming into force of the Merchant Shipping Act 1988, did the rules change so that a British ship was entitled to be registered, and was the only type of ship entitled to be registered, in the United Kingdom, but was no longer under any obligation to be registered. Now, under the Merchant Shipping Act 1995, the test is that a majority of the shares in the ship must be owned by someone with 'a British connection'.[3]

Since the middle of the twentieth century there has been a marked change in the operation of ship registries and the expression 'flag of convenience' is now well known. The historical background is that, before and after the Second World War, several countries began to open up their ship registers to all comers. Beginning with the use of the Panamanian flag by US cruise ship operators during the prohibition years, the trail blazers were the so-called PanLibHon registers – Panama, Liberia and Honduras. Although Honduras has declined dramatically in importance (it is now only just inside the top 50 registries in terms of gross tonnage), Panama and Liberia have had sufficient success to make them, by gross registered tonnage, the world's two largest fleets. More recently, other countries have joined the club, including Cyprus, the Bahamas and the Marshall Islands.

The chief distinguishing characteristic of these open registers is their lack of restriction. As will be seen in more detail later, anyone can, broadly speaking, register his ship on one of their own country. On the contrary, and certainly for larger ships and larger owners, one is more likely to find, for example, an American bank, acting through its London office, lending to a Greek-controlled owning company and securing itself on a Liberian registered ship. There may be a degree of patriotism – but if a foreign bank can offer better terms, then owners, accustomed to international dealings in the everyday operation of their ships, will not be troubled about dealing with foreign lenders.

There are two common elements. First, the universal currency of international shipping is the US dollar. Loans in other currencies, except to owners who operate their vessels within narrow geographical confines, such as ferry operators, and therefore have the bulk of their income in local currency, are relatively rare. For ships that trade worldwide, income will almost invariably be in US dollars and ships will be bought and sold in US dollars; hence, to limit exposure to currency fluctuations, loans (and loan repayments) will be in US dollars. (Although multi-currency options appear in facilities from time to time, they tend normally to be dollar based.)[2]

The second common element is the importance of English law. London remains one of the world's major shipping centres. Although major British owners are now few and far between, and the importance of the Baltic Exchange for fixing employment for ships has diminished as technology has advanced, a very large proportion of the world's fleet is insured or reinsured through the London insurance market and much financing is still done by banks in London. English law, and London arbitration, are common choices of parties to shipping contracts, such as charterparties, even where those parties have no obvious connection with England and where the ship may never come near an English port. This is not to play down the role of other legal systems: it is simply that historically English law has attained an ascendancy in the world of shipping which other legal systems have yet to succeed in shaking off.

Ship registration

Assets, generally speaking, fall into three categories. There are immovables (principally land); tangible movables (for example, ships, cars or furniture); and intangibles (for example, bank balances and trade creditors). Commonly, immovables are subject to some form of registration system – for example, in England title to most land is registered at HM Land Registry – but movables are not. Ships, however, are an exception to this general rule.

There are several reasons for this. First, ships travel the world. For a large part of their life they are on the high seas, outside the jurisdiction of any particular country. Secondly, they are more valuable assets than many other tangible movables and lenders will normally want to take security over them (which is difficult to do in many legal systems on an unregistered asset without physical possession). Thirdly, they are strategic assets, of great value in time of war. Fourthly, for economic and political reasons countries may wish to restrict certain types of trade to their own flag ships.

Not surprisingly, with a view to controlling the numerous national systems of registration and preventing a complete free for all, international law has intervened, chiefly by a series of United Nations (UN) conventions, mostly in the 1980s, including the 1982 UN Convention on the Law of the Sea (the 1982 Convention). Now signed by approximately 150 countries, the 1982 Convention only came into force on 16 November 1994, one year after it had been ratified by the required minimum of 60 countries.

Similarly, following the terrorist attacks of 11 September 2001, governments recognised the need to put in place a worldwide set of security rules for both ships and ports, to make the shipping industry less vulnerable to terrorist attack. The International Ship and Port Facility Security Code (ISPS Code) came into force on 1 July 2004[5] and, with a very few exceptions, applies to all passenger and cargo ships and to all port facilities servicing such ships, engaged in international voyages. Ship registries are responsible for setting the security levels and requirements for ships entitled to fly their flag and for monitoring compliance. A ship without valid ISPS Code documentation will not be able to trade and, as with the ISM Code, open registries who are unable to carry out their ISPS Code obligations will find that no matter how attractive a choice they may otherwise be, they will not be acceptable to either owners or lenders.

As well as the traditional open registers, such as Liberia and Panama, two other types of register have developed. The offshore register is typically a register established in a colony or dependency of a particular country, with a view to attracting the registration of ships from that country which might otherwise go to an open register. The United Kingdom led the way, with offshore registers in places as diverse as Bermuda, Gibraltar, the Isle of Man and the Cayman Islands and Dutch shipping has taken advantage of the Netherlands Antilles.

In many cases, these dependencies are well established as centres for offshore finance and the use of their ship registers has followed almost accidentally. Their general approach is to allow owners to fly the flag of the home country (such as the Red Ensign), while imposing less strict requirements for ownership and crewing than the home register. There may also be tax advantages in operating in a tax haven jurisdiction with low, or no, corporation tax and, very possibly, no obligation to deduct income tax or national insurance at source from officers' and crews' wages. Many of the offshore registers are also classified as flags of convenience by the ITF, either completely or on a vessel-by-vessel basis depending on the nationality of the vessel's ultimate owner.

The other type of register is the international register. This is much the same as the offshore register but does not rely for its existence on the accident of a convenient dependency and is set up in the home country and run parallel to the domestic register. Much the most successful example of this species is the Norwegian International Ship Register (NIS), set up in 1987. Other countries with international registers are Denmark, Turkey and Italy. At the time of writing, Russia is also about to set up a second register and France is replacing its offshore register (Kerguelen) with a second register. Conditions of entry differ, but the principal aim is similar to that of the offshore register: the national flag may be flown without some of the restrictions that otherwise entails. However, unlike the accidental development of some of the offshore registers in established offshore financial centres, the international registers are entirely creatures of expediency, established in a conscious effort to attract tonnage back from the open registers.

Statistics reveal the rise of the open registers. Exhibit 1.1 shows the world's 10 largest fleets, by gross registered tonnage (grt), at five-yearly intervals since 1974.[6] The rise of the open registers will be apparent, though it is worth noting the continuing significant market shares of some of the traditional maritime nations, notably Greece, Japan and, until recently, the United States. The Greek situation is worthy of note, for some time ago Greece took these registers, as long as the ship satisfies the register's requirements as to, for example, age and technical standards. Sometimes, as in Cyprus, it is necessary to set up a locally registered company to own the ship, but normally a shelf company can be acquired in a matter of hours and usually there are no restrictions on the nationality or identity of the directors or shareholders. Chapter 11 deals in more detail with vessel registration and the ownership requirements for various flags.

As well as being unrestricted as to ownership, the open registers for the most part impose no restrictions on the nationality of the officers and crew employed on vessels registered on them, though officers must normally satisfy certain technical standards. Again, this compares with the traditional national registers, where strict requirements for officers and crews, either as to nationality or as to pay rates, are frequently imposed. This has a dramatic impact on the running costs of a vessel, for the obvious reason that crews from less developed countries come much cheaper than those from developed nations. Some national registers have fought back, with the introduction by their governments of tonnage tax schemes. In addition to providing strong tax incentives for owners to enter the scheme and thereby boost that country's maritime industry, many tonnage tax schemes have made a commitment by the prospective tonnage tax company to seafarer training a compulsory requirement for acceptance of that company on the scheme. Such a requirement helps to expand the pool of qualified officers in that country.

Nevertheless, crews from developing countries have become, to a large extent, the norm. Many owners will say, not without some justification, that without the latitude to employ cheap crew they would have been forced out of business long ago. Their arguments have not found much favour with the International Transport Workers' Federation (ITF) which has waged a long and vigorous campaign to protect these seamen from exploitation. One result of the campaign has been the designation by the ITF of certain registers – principally the open registers – with the supposedly pejorative term 'flag of convenience'. Any ship registered under a flag of convenience is liable to be subject to action such as blacking by members of ITF-affiliated unions unless it can produce a certificate that it has satisfied the ITF that its crew's conditions of employment meet certain minimum standards.

The ITF has another concern, which brings us to another criticism often made of the open registers. The ITF is not just concerned with the financial well-being of seafarers, but also their physical well-being, and continues to campaign against what it sees as unacceptably low safety standards on ships. The safety standards applicable on board ships are ultimately a matter for the flag state, which may or may not adhere to certain internationally accepted standards. Safety concerns and a desire to raise standards worldwide, resulted in the International Maritime Organisation (the United Nations' agency responsible for improving, among other things, maritime safety) introducing the International Safety Management Code (ISM Code) in the mid-1990s.[4] The ISM Code has made it compulsory since 1 July 1998 for ships and their owners and managers to have adequate safety management systems in place, both on board and ashore. Governments are responsible for carrying out ISM audits and for issuing certificates showing that the ISM Code has been complied with by a ship and its owners and managers. Ships without valid ISM Code certification are prevented from trading. Owners (and their lenders) will therefore avoid registries who fail to monitor these international standards to an acceptable level and have neither the resources nor the technical expertise under their control to meet their obligations under the ISM Code.

Exhibit 1.1 *(Continued)*

1989		
1	Liberia	47,892,529
2	Panama	47,365,362
3	Japan	28,030,425
4	USSR	25,853,712
5	Greece	21,324,340
6	USA	20,587,812
7	Cyprus	18,134,011
8	Norway	15,596,900
9	PRC	13,513,578
10	Bahamas	11,578,891
1994		
1	Panama	64,170,219
2	Liberia	57,647,708
3	Greece	30,161,758
4	Cyprus	23,292,954
5	Bahamas	22,915,349
6	Japan	22,101,606
7	Norway (NIS)	19,976,489
8	Russia	16,503,871
9	PRC	15,826,688
10	Malta	15,455,370
1999		
1	Panama	99,749,102
2	Liberia	57,179,231
3	Malta	25,518,507
4	Bahamas	25,478,573
5	Greece	24,251,781
6	Cyprus	22,239,967
7	Singapore	21,126,078
8	Norway (NIS)	18,428,456
9	Japan	14,538,938
10	USA	14,252,729
2004		
1	Panama	127,753,074
2	Liberia	52,229,133
3	Bahamas	32,706,405
4	Greece	32,035,847
5	Hong Kong	25,405,871
6	Singapore	24,975,904
7	Malta	21,972,693
8	Marshall Islands	21,949,834
9	Cyprus	20,525,024
10	PRC	18,015,105

Sources: *Lloyd's Register of Shipping Statistical Tables* 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyds Register Fairplay data*, 2006.

positive steps to arrest the trend towards flagging out. Although Greek owners have been no more immune than others to the economic pressures of the shipping industry since the Second World War, and many Greek owners have flagged out, particularly to Cyprus, successive Greek governments have sought, by the use of fiscal incentives, to maintain the use of the Greek flag by Greek owners.

Exhibit 1.1

The world's top 10 registered fleets by grt – 1974 to 2004

1974

1	Liberia	55,321,641
2	Japan	38,707,659
3	UK	31,566,298
4	Norway	24,852,917
5	Greece	21,759,449
6	USSR	18,175,918
7	USA	14,429,076
8	Panama	11,003,227
9	Italy	9,722,015
10	France	8,834,519

1979

1	Liberia	81,528,175
2	Japan	39,992,925
3	Greece	37,352,597
4	UK	27,951,342
5	USSR	22,900,201
6	Norway	22,349,337
7	Panama	22,323,931
8	USA	17,542,220
9	France	11,945,837
10	Italy	11,694,872

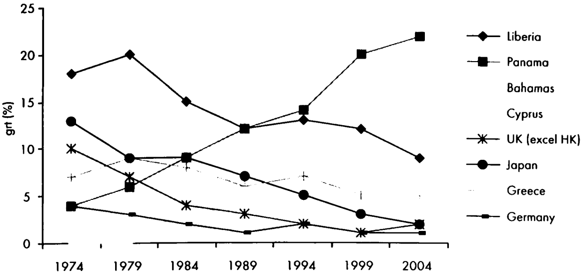
1984

1	Liberia	62,024,700
2	Japan	40,358,749
3	Panama	37,244,233
4	Greece	35,058,593
5	USSR	24,492,469
6	USA	19,291,868
7	Norway	17,662,916
8	UK	15,874,062
9	PRC	9,300,358
10	Italy	9,157,867

(Continued)

Exhibit 1.4

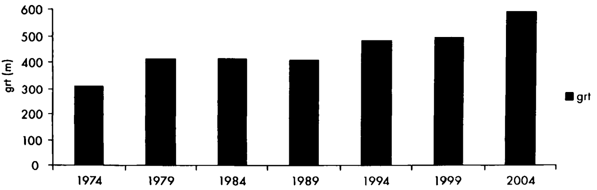
Comparative percentage of world fleet by grt 1974–2004



Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyd's Register of Fairplay Data*, 2006.

Exhibit 1.5

Changing size of world fleet by grt 1974–2004

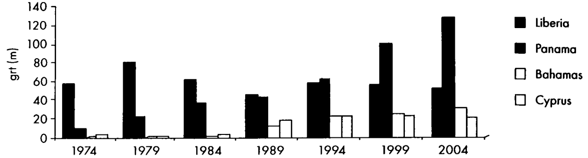


Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyd's Register of Fairplay Data*, 2006.

age of vessel on the world's registers. Singapore (11 years) and Liberia, Hong Kong and the Marshall Islands (12 years) have the youngest fleets. Traditional national registers such as Sweden (30 years), Finland (31 years) and Canada (29 years) are among the oldest, and the Isle of Man (10 years) is the youngest of all. An understanding of these basic facts of shipping life is essential for anyone operating in shipping finance. Later on, we will look at some of the more detailed requirements of the various registries.[6] What, though, is the significance of the flag of a ship for a lender?

Exhibit 1.2

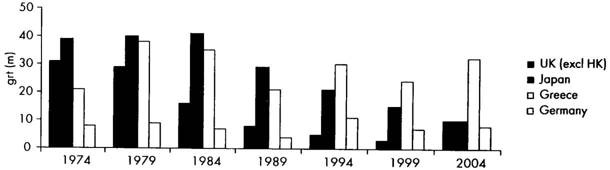
The world's four largest open registers by grt 1974–2004



Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyd's Register of Fairplay Data*, 2006.

Exhibit 1.3

Four traditional maritime nations grt 1974–2004



Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyd's Register of Fairplay Data*, 2006.

Exhibit 1.2 shows, by way of illustration, the record of the four largest open registers – Liberia, Panama, Cyprus and the Bahamas. The dramatic rise of the Bahamas is very noticeable, as is the continuing rise of Panama. By way of contrast, Exhibit 1.3 shows the relative performance of four traditional maritime nations; Japan, the United Kingdom, Greece and the Federal Republic of Germany. The relative stability of the Greek flag, under generally pro-shipping governments has already been noted; the demise of UK flag shipping, under a series of governments which have consistently adopted a non-interventionist shipping policy, is readily apparent although there has been a marked growth in the last five years shown, perhaps due to the UK tonnage tax scheme. In each case, the figures shown are for the gross registered tonnage registered under that flag in the years in question.

Exhibit 1.4 compares all eight nations in terms of percentage of the world fleet (again by grt) and, for the sake of completeness, Exhibit 1.5 shows the changing size of the world fleet during the same period. The moral is clear. The economics of lower operating costs prevail over the fine words of the UN Conventions. It is also of interest to note the average unaware of the country of the primary register. This lack of transparency can create concern for lenders, even though their security rights should not be adversely affected.

- As mentioned above, the vessel will fly the flag of the country of the secondary register for the duration of the bareboat charter (though sometimes subject to periodic renewal of the temporary registration during the life of the charter).

Charterers of vessels let on bareboat charter may require the vessel to be temporarily registered on the register of their choice. This is particularly important (a) where specific cargoes or geographical trades are limited to vessels flying certain flags; (b) in leasing transactions where the lessee/charterer will not want the choice of the vessel's flag to be determined by any mandatory requirements of the lessor's country of incorporation; and (c) where the country of the charterer's chosen register does not have a system of mortgage registration considered adequate by international banks – financing through bareboat charter registration (that is, lending to a single ship company in an acceptable jurisdiction then permitting bareboat charter registration by the ultimate shipowner, as bareboat charterer, in a less acceptable jurisdiction) can resolve this issue.

The one-ship company

Apart from 'flag of convenience', the other shipping term with which many laymen will be familiar is 'one-ship company'. Commonly, though by no means invariably, a shipowner will establish a separate company to own each ship in his fleet. Occasionally, this will be dictated by the requirements of the flag – for example, the requirement (generally speaking) for a Liberian ship to be owned by a Liberian company will mean that the ship will necessarily be in separate ownership from a Cyprus flag ship in the same ultimate ownership, which must be owned by a Cypriot company. There may be administrative or fiscal advantages. However, the main reason relates to arrest.

The International Convention relating to the Arrest of Seagoing Ships was signed on behalf of the United Kingdom in 1952. Article 3 of the convention provides that 'a claimant may arrest either the particular ship in respect of which the maritime claim arose, or any other ship which is owned by the person who was, at the time when the maritime claim arose, the owner of the particular ship'. Article 3 was introduced into English law by the Administration of Justice Act 1956. The current English law on what has come to be known commonly as 'sister ship arrest' is found in Section 21 of the Supreme Court Act 1981. This provides that:

> [...] in the case of any such claim as is mentioned in Section 20 (2) (e) to (r),[8] where:
>
> (a) the claim arises in connection with a ship; and
>
> (b) the person who would be liable on a claim on an action *in personam* ('the relevant person') was, when the cause of action arose, the owner or charterer of, or in possession or control of, the ship, an action *in rem*[9] may (whether or not the claim gives raise to a maritime lien on that ship) be brought in the High Court against:
>
> (i) that ship, if at the time when the action is brought the relevant person is either the beneficial owner of that ship as respects all the shares in it or the charterer of it under a charter by demise; or

The basic answer is that the law of the flag will invariably govern the mortgage which will be a fundamental part of the lender's security. Again, detailed consideration of the mortgage laws of the principal ship registration jurisdictions will come in Chapter 7, but the crucial question for a lender will always be whether the mortgage will give the lender the security he requires. A lender will also always be concerned to ensure that the ship satisfies the requirements of the flag state. If it does not, the registration will be liable to be avoided and with it may go the lender's mortgage. Other factors for a lender will be the extent of any regulatory requirements with which the owner will need to comply as a result of having his ship registered on the flag in question – for example, a Cyprus ship must be owned by a Cypriot or a Cypriot company, and the lender will be concerned to ensure that a Cypriot owning company has suitable offshore status to allow it to service foreign currency debt.

The policy adopted by lenders differs. Some will have no concern about the flag flown by the vessel, so long as they are convinced, perhaps on the strength of an opinion from a local lawyer, that their security by way of registered mortgage is adequate. Others, with the same end in mind, will turn down without question ships not registered on certain registers with a proven track record of security enforcement by mortgagees.

Lenders should, however, look rather further than this. For example, a lender should consider whether the vessel's flag state will impose and enforce acceptable safety and technical standards. This is especially true, as we have seen, following the introduction of first the ISM Code and then the ISPS Code. A lender will, generally speaking, be looking to the ship's earning capacity as the primary source of the debt service, and will be none too keen to have the ship delayed or detained because of failure to meet acceptable technical standards. He will also need to consider the way in which the legal system of the flag state deals with maritime liens: in some countries a wide range of claims against the vessel will take priority to the rights of a mortgagee on a forced sale.[7] Lastly, the political stability of the flag state may be an issue.

Bareboat charter registration

Bareboat or demise charter registration, frequently known as parallel registration, is a system that has developed in certain (though by no means all) countries. It allows the registration of a vessel in that country to be temporarily suspended for the duration of a bareboat, or demise charter, with the vessel being registered in the name of the charterer on an alternative register for the duration of the charter, during which time it may fly the flag of the charterer's chosen register.

The precise conditions on which different countries permit bareboat charter registration out from, or in to, their ship registers vary, and are detailed in Chapter 11. However, some of the relevant features are listed below.

- The owner's title remains registered on the primary register, his registration being not terminated, but merely suspended.
- Similarly, mortgages will remain registered on the primary register. Mortgagees' consent will usually be required for any bareboat charter registration, but there is frequently no procedure for the mortgage to be registered or even noted on the secondary register – as the vessel will be flying the flag of the country of the secondary register third parties will be

by mortgages over the owning companies' vessels. Where one-ship companies are used, shipping finance is asset finance in the narrowest sense of the term because if the ship, for whatever reason, disappears the lender will, for all practical purposes, have no recourse to the borrower and will be left to look to his secondary lines of security.

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[1] Lord Justice Roskill, the 'PANGLOBAL FRIENDSHIP' [1978] 1 Lloyd's Rep. 368 @ 371.

[2] See Chapter 2.

[3] See Section 9 of The Merchant Shipping Act 1995 and Regulations 7 and 8 of The Merchant Shipping (Registration of Ships) Regulations 1993, Regulation 7 as amended by The Merchant Shipping (Registration of Ships) (Amendment) Regulations 1998, which came into force on 1 January 1999 and the British Overseas Territories Act 2002, which came into force on 26 February 2002 and Regulation 8 as amended by The Merchant Shipping (Registration of Ships) (Amendment) Regulations 1994.

[4] The International Management Code for the Safe Management of Ships and for Pollution Prevention, as adopted by the Assembly of the International Maritime Organisation on 4 November 1993 by Resolution A.741 (18) and incorporated on 19 May 1994 as Chapter X of the Safety of Life at Sea Convention 1974.

[5] The International Ship and Port Security Code as adopted by the Conference of Contracting Governments to the Safety of Life at Sea Convention 1974 on 13 January 2002 and incorporated as Chapter XI-2 of the Safety of Life at Sea Convention 1974.

[6] See Chapter 11.

[7] For further details see Chapter 7.

[8] These categories include (among others) claims such as claims for general average, disbursements, crew wages, salvage, towage, damage done by the ship and loss or damage to goods carried on board.

[9] Hence the right to arrest.

[10] [1988] 2 Lloyd's Rep. 411.

[11] Ibid., 415.

[12] Ibid., 415.

> (ii) any other ship of which, at the time when the action is brought, the relevant person is the beneficial owner as respects all the shares in it.

In other words a claimant is not restricted to arresting the ship against which his claim arose, but may also arrest any other ship in the same beneficial ownership when the action was brought. Most other maritime jurisdictions have similar provisions. Some, for example South Africa, have even more extensive sister ship arrest rights.

The obvious solution, therefore, is to register each ship in a particular owner's fleet in the name of a different company, each company being a subsidiary of the parent company or owned by the individual shipowner. Certainly in English law, the separate legal personality of each company is sufficient to prevent a ship owned by one of these one-ship companies being arrested for claims against other ships in the same group. This was tested as recently as 1988, when the Court of Appeal gave judgment in the case of the 'EVPO AGNIC'.[10] The then Master of the Rolls, Lord Donaldson of Lymington, summarised the position as follows.

> The truth of the matter, as I see it, is that Section 21 [of the Supreme Court Act 1981] does not go, and is not intended to go, nearly far enough to give the plaintiffs a right of arresting a ship which is not the 'particular ship' or a sister ship, but the ship of a sister company of the owners of the 'particular ship'.[11]

He drew an important distinction between the beneficial ownership of the ship and the beneficial ownership of the shares in the owning company, holding that the ship (owned by a traditional one-ship company) was both legally and beneficially owned by that company and that:

> [...] any division between legal and equitable interests occurs in relation to the registered owner itself, which is almost always a juridical person. The legal property in its shares may well be held by A and the equitable property by B, but this does not affect the ownership of the ship or of the shares in that ship. They are the legal and equitable property of the Company.[12]

The use of the one-ship company has two principal implications for lenders. The first is an advantage. It makes the mortgaged ship immune from arrest for claims against other ships in the owner's fleet (though if the lender has secured himself by mortgages on all the ships in the fleet this advantage disappears). No lender wishes the earning capacity of a mortgaged ship to be adversely affected as a result of a claim totally unrelated to that ship.

The second implication is that the lender will be lending to a borrower with no assets of any consequence other than the ship. Apart from the ship (and its insurances and earnings) the borrower will be unable to offer any other assets to the lender by way of security or as a source of income for debt repayment and service.

This makes the enforceability of the mortgage of crucial importance. It also means that the lender must look elsewhere for additional security, often by way of a guarantee from the ultimate parent of the one-ship company, perhaps backed by security over its assets. An alternative approach, sometimes used for large corporate groups, is for the lender to lend to the parent and to take guarantees from each shipowning subsidiary, those guarantees being backed on the borrower's; after all, a bank would be very wary about lending to an owning company whose executives have changed constantly at three- or four-year intervals or who have no practical experience of working through the issues raised by market downturns.

At the other end of the banking spectrum there are the specialist shipping banks such as those found in Germany and the Netherlands. Here the pros and cons are exactly the reverse of those of the large international banks. Bankers in the specialist banks will frequently have been in shipping finance for many years and it is not uncommon for them to have a background of sea-faring or working for shipowners. Either of these backgrounds will give the banker a valuable insight into the workings of the shipping industry. Set against this, however, is the vulnerability of the specialist banks to industry-driven market forces (the 'all the eggs in one basket' syndrome). Outlooks may be too narrow – specialist banks are often perceived as the most traditional and least innovative. Often, too, the lack of a substantial capital base leads to a requirement to syndicate from the start facilities which other banks would underwrite themselves.

Between the two extremes are certain smaller domestic or international banks which have traditionally had a shipowning customer base, and lastly, there are government owned or backed banks in many countries, which generally limit their lending to support their domestic owners or domestic shipbuilding.

Which type of lender should a borrower choose? The answer depends very much on what the borrower wants from his lender – each type has its own particular attraction. Some borrowers will appreciate the stability and personal nature of their dealings with the small specialist banks. Others will prefer the, perhaps, greater flexibility of dealing with the big boys. The upturn in vessel values in 2003–2006 brought some new names into the ship finance market, at a time when margins fell strongly and (in some cases) covenants were relaxed. Those without a strong background in shipping may find it harder to deal with downturns in the freight markets and in asset values.

Loan and guarantee facilities

The term loan

Most lending secured on second-hand ships is by way of term loan or reducing revolving credits. In other words, the lender will lend to the shipowner a fixed amount repayable over a set period of time – the 'term'. In its simplest form, the loan will be available to the borrower in one drawing only and will be repayable in equal instalments over the duration of the term, either by way of repayments (in the case of a term loan) or by repayments and redrawings against reducing availability amounts (in the case of a revolver) most likely payable every three or six months. As has already been seen, the US dollar is the almost universal currency of shipping, and loans (other than those made by the domestic branches of US banks and the less common loans made in other currencies) will therefore generally be funded in the Eurodollar markets in western Europe and, most commonly, in London.

Interest will almost invariably be fixed by reference to the London Interbank Offered Rate (Libor), now frequently by reference to the Reuters ISDA page or its Telerate equivalent rather than to any actual cost of funds to the particular lending bank. The bank's return on the facility thus derives from the margin over Libor which it is able to charge the borrower (and any

Chapter 2

The financing of second-hand ships

Updated by Mark Russell

From 2004 onwards, reflecting the boom times in the shipping market, there has been considerable activity in the newbuilding markets and in large fleet refinances, where owners have locked into the comparatively cheap pricing available in the bank market in 2004/2006, but traditionally the financing of second-hand ships remains the bread and butter of a shipping bank's business.

Self-evidently, bank finance for second-hand ships is generally used to assist an owner in purchasing a second-hand ship, but it is also often used in refinancing existing facilities secured on ships already owned by the borrower. Refinancing is largely the result of competition between lenders – owners will generally approach more than one lender to finance a new acquisition and it is not uncommon for owners to switch lenders during the life of a facility where a different lender is able to offer better terms, particularly to refinance balloon instalments at the end of the life of a loan.

Types of lender

Most of the analysis contained in this chapter, as elsewhere in this book, is specifically directed at bank lending. That is not to say that many of the general principles are not equally applicable to, for example, inter-company borrowing or borrowing from institutions other than banks. Except perhaps in financing through tax-based leasing and, for some larger owners, financing through the issue of debt securities and IPOs (Initial Public Offerings) on a stock exchange there is little institutional lending to the shipping industry other than by banks and, to a relatively minor extent except in their own particular geographical market, by the Japanese trading houses. Where companies other than banks are lending, it is important always to check their constitutional documents and to take appropriate local legal advice, in order to ensure that the lending company has the corporate capacity to lend and take security, and that any local restrictions (for example, as to exchange control) are complied with.

The majority of shipping lending is carried out by large international commercial banks, for which shipping lending will be just one of a vast range of products offered to customers. This has both advantages and disadvantages for borrowers. On the plus side, the major international banks will have a substantial capital base and will generally be able to offer the borrower their own in-house treasury products, electronic banking and other facilities which are becoming increasingly important as shipowner borrowers become more sophisticated. On the minus side, large banks may see shipping as something of a backwater and simply a training ground for bank executives, with the result that there can be a lack of continuity of personnel and expertise. In a specialised and cyclical industry such as shipping, personnel with experience and proven track records are just as important on the bank's side as they undoubtedly are of the facility. Revolving facilities are particularly appropriate for shipowning groups that buy and sell ships on a regular basis, allowing them to repay on selling vessels and draw on the revolving facility to purchase new tonnage (approved by the bank) without having to negotiate a new facility. Revolving facilities can also be useful where the loan is being made available for working capital purposes rather than for buying vessels into the group.

Apart from allowing repayments to be redrawn, a revolving facility differs little from a multiple drawdown term loan. Normally the whole facility will still need to be repaid by a fixed date, interest will be calculated and fixed in much the same way, and the loan documents will contain identical representations and warranties, covenants, conditions precedent, events of default and so on.

The guarantee facility

Although banks may be asked to issue guarantees in connection with the financing of newbuildings, it is unusual for second-hand ships to be sold on credit terms. On the rare occasions when a seller will be prepared to deliver a ship to a buyer without being paid in full, the seller will rarely rely on the credit of a one-ship company and will normally require comfort from a third party, usually a bank, unless the buyer can produce a satisfactory guarantee from, for example, its parent company.

In structural terms, a guarantee facility is straightforward. The bank agrees to issue the required guarantee when called on to do so, while the owner agrees to counter-indemnify the bank for any sums that the bank is called on to pay under the guarantee and pays the bank a commission, usually calculated on an annual basis, for its services. The owner will secure the counter-indemnity in the same way as a loan, by mortgaging the ship to the bank and by granting some or all of the other security discussed later. Although historically there were doubts in some jurisdictions about the ability of a shipowner legally to grant a mortgage to secure a contingent obligation, those doubts have now been resolved in all major ship registration jurisdictions.

In a guarantee facility, the critical factor for the bank is to ensure that it will be able to enforce the counter-indemnity as soon as it has paid under its guarantee. Counter-indemnities will, therefore, contain many of the protective clauses found in guarantees[1] and, most importantly, will contain provisions imposing liability on the owner as soon as the bank makes a payment in good faith under the guarantee, even if the bank is subsequently shown not to have been under a legal obligation to do so.

Syndicated loans

Historically, as ship values rose it became increasingly common for individual banks to wish to share their lending obligations with others. Sometimes this derived from regulatory requirements, either external or internal, limiting banks' ability to lend, or perhaps to lend to a particular country or in a particular industry such as shipping. At other times it derived purely from a commonsense desire to spread risk. Hence, particularly with large loan facilities to groups, syndicated lending became more common. In a syndicated loan a group of banks will each commit themselves to make part of the loan. One bank (the agent) will fees payable by the borrower to the bank). The size of the margin that the bank is able to charge is very much a reflection of the standing and bargaining position of the borrower, of the perceived risk to the bank in doing the particular deal and of the number of banks chasing that borrower's business. Prime shipping names, whose accounts are sought by several banks, are able to borrow at a very fine margin – in the current competitive climate at significantly less than 1 per cent over Libor. Owners whose track record is less established or who have a lower reputation in the market will pay higher margins.

The actual interest rate will be fixed periodically during the term of the loan, with the borrower usually given the option of fixing his interest rate for three- or six-month periods throughout the term. Frequently one month (sometimes at a higher margin), nine months and 12 months will also be available options. The borrower is normally permitted to select the length of each interest period two or three banking days before the interest period begins, to enable the bank to borrow matching funds in the money market if necessary and to enable the borrower to form an on-the-spot assessment about future interest rate movements. Loan documents will contain provisions fixing the length of the interest periods if the borrower fails to make his selection. Interest will be payable at the end of each interest period, and it is normal for borrowers to be required to pay interest at least every six months, even if the interest period is longer. Borrowers may, if they wish, protect themselves from extreme interest rate movements or fix interest rates for longer periods by using some of the increasingly developed and tailored treasury products on offer from most lenders, for example, interest rate swaps, caps, collars and floors (see Chapter 5), and increasingly banks are requiring some or all of the interest exposure on a transaction to be fixed by means of such an instrument.

The length of the term can vary enormously. Somewhere between four and 10 years is probably commonest in second-hand ship financing and up to 12 years for newbuilding finance. Equal quarterly or half yearly repayments have the attraction of simplicity but there is no point in fixing repayment instalments that bear no relation to the earning capacity of the vessel or vessels being financed. Hence many facilities, particularly when second-hand ship values are high, provide for a 'balloon' repayment, that is, a significantly larger final repayment, the intention being that the borrower will finance the repayment of the balloon either by refinancing with the same, or another, lender, or by selling the vessel. For certain types of vessel, for example, fishing or cruise vessels, where income does not arise at a constant rate over the course of a year, a seasonally adjusted repayment profile may be more appropriate.

Making the loan available in a single drawing is obviously appropriate where the loan is being made to assist the borrower to purchase a vessel. However, banks will often offer term loan facilities to groups of companies to enable them to purchase more than one vessel, or to refinance facilities secured on more than one vessel. In those circumstances, the bank may wish to allow multiple drawings up to the maximum amount of the facility. Drawings will be subject to a minimum amount, and there will be a cut-off date after which no further drawings will be permitted.

The revolving facility

Term loan facilities will provide that amounts repaid cannot be re-borrowed. In a revolving facility, amounts repaid are made available for re-borrowing, up to the maximum amount

Multi-currency options

Although most owners will want to borrow in US dollars to match their operating income, borrowers will occasionally wish to have the option to convert their loans into other currencies. While this can be done by using such treasury products as currency swaps, multi-currency options are sometimes specifically written into loan agreements. The borrower will be permitted (usually when selecting his interest period) to specify an alternative currency in which the loan – and hence the repayments – will be denominated for the duration of that interest period. This will allow the borrower to take advantage of lower interest rates applicable to certain currencies, though it will also expose him to currency fluctuations if he selects a currency other than that in which his operating income arises.

The risk for the bank is that the selected currency will move too far from the US dollar (or other base currency) during the interest period, potentially throwing into disarray both the bank's expected return on the facility and the borrower's ability to service the loan. Hence, loan agreements containing multi-currency options normally require the borrower to make additional repayments to ensure that the outstanding balance of the loan in the base currency remains within a certain tolerance of what the outstanding balance would be had the loan repayments remained in the base currency. The loan agreement may restrict the optional currencies available to the borrower or allow him to denominate the loan in any currency that the bank is readily able to obtain in the market.

The importance of the international element

It is a rare ship finance facility where lender and borrower are incorporated in the same country which also happens to be both the vessel's country of registration and the jurisdiction governing the loan agreement. A more common situation would be for, say, a German bank to lend to a Liberian incorporated borrower, secured on a Panamanian flag ship, with a Greek personal guarantor and a loan agreement governed by English law. The lender will, therefore, need to ensure not only that his loan agreement is valid and enforceable under English law, but also that the borrower has the necessary capacity under Liberian law to enter into the agreement and meet its obligations and to grant security over its assets; that the vessel and the mortgage are properly registered under Panamanian law, and the mortgage valid under Panamanian law; and that the personal guarantor is entitled, as a matter of Greek law, to enter into the personal guarantee. The lender will need to consider not only corporate capacity and directors' and shareholders' powers but also exchange control, withholding tax, registration of security, any formalities required by the local law of the place where the documents are executed[2] and many other matters.

In ship finance transactions, therefore, probably more than in any other sort of lending, banks are heavily dependent on a wide range of legal advisers. In our hypothetical situation, the bank will probably rely on its English solicitors to draw up the loan agreement and security documents (even the Panamanian mortgage – most English solicitors who specialise in ship finance will be able to draft mortgages governed by the laws of most major ship registration jurisdictions). In turn, however, the bank will require formal legal opinions to be issued by lawyers in all other relevant jurisdictions confirming that, to the extent relevant, their local laws have been satisfied.

administer the facility on behalf of the syndicate, dealing with the fixing of interest rates, receiving repayments and accounting to the other syndicate members. Frequently, though not invariably, the agent role will be taken by the bank making available the largest share of the total loan.

Syndicated loan agreements will make clear that each bank's obligation to lend is entirely separate from the obligations of the others. In other words, if one bank, for any reason, fails to make its part of the loan available, the other members of the syndicate are not obliged to step in. Syndicated loan agreements will also contain a series of provisions regulating the relationship between the syndicate members and the agent. (This is sometimes contained in a separate agreement.)

For a borrower, borrowing from a syndicate presents few changes from borrowing from a single bank because the borrower's everyday relationship will normally be with the agent alone. The banks, however, must agree between themselves at the outset whether such decisions as amendments to the facility, the enforcement of security and the giving of consents are to be made by the agent alone, by the banks acting unanimously or by a specified majority (by number or value) of the banks. Generally, unanimity will be required for the most major decisions, such as the release or variation of any security, the waiver of any payments, the extension of any repayment or interest payment dates, or any step that may increase the obligations of any of the banks. A syndicated loan agency clause (or agreement) will also contain provisions protecting the agent, for example, clauses putting the onus for credit assessments onto each lending bank and making clear that the agent is only obliged to account to the other syndicate members for amounts actually received. It is, however, important for a borrower from a syndicate to appreciate that although he may only deal directly with the agent, the agent's relationship with the other lenders is likely to give the agent less flexibility in dealing with the borrower than a sole lender would have. Problems have arisen, particularly with syndicates containing numerous or less-experienced banks, when one bank has effectively been able to hold the others to ransom by vetoing, for example, a planned restructuring, although as banks take bigger 'tickets', even with increasing loan sizes the number of banks in a typical syndicate has probably reduced over the last few years.

One question that often arises in syndicated shipping loans is whether the security should be taken in favour of all the banks or simply in favour of the agent (or another bank as security agent or trustee) on behalf of the members of the syndicate. So long as the agency clause or agreement, or a separate security trust deed, properly deals with the relationship of the syndicate members both to each other and to the security agent or trustee, and so long as security documents make clear that they are taken by the security agent or trustee on behalf of the syndicate members, it is much neater and administratively easier (for example, when it comes to the discharge or variation of the security) for the security documents to be in favour of one bank only.

However, care must be taken to ensure that ship mortgages, which will be governed by the law of the flag, may, according to their local law, be taken in favour of a security agent or trustee. A Liberian mortgage, for example, may be taken in favour of one bank acting as trustee for others, but not acting as agent only, hence the need both for an express declaration of trust of the benefit of the mortgage by the trustee bank in favour of the syndicate members, and for the mortgage to state on its face that the mortgagee acts as trustee.

Clause	**Heading** *(continued)*
13	Assignment, syndication and sub-participation
14	Payments, mandatory prepayment, reserve requirements and illegality
15	Notices
16	Miscellaneous
17	Law and jurisdiction
18	Headings and contents page
19	Letter of offer
Appendix A	Form of drawdown notice
Appendix B	Form of mortgage
Appendix C	Form of deed of covenants
Appendix D	Form of assignment
Appendix E	Form of guarantee

Most shipping term loan agreements will contain a similar list of clauses, though perhaps arranged or subdivided differently.

It will be seen that a shipping term loan agreement differs little in structure from any other, nor is it the purpose of this book to deal in detail with areas covered in standard texts on banking law. This section will, therefore, look at these clauses in general terms and address the provisions peculiar to shipping finance.

1 Definitions and interpretation

Curiously, the most complex part of the loan agreement is often the clause that defines a wide range of terms used elsewhere in the documents. Most of these are relatively standard in any form of loan agreement but in shipping loans additional definitions often appear, covering the vessel or vessels being financed or refinanced, and earnings, insurances and requisition compensation.[8]

2 The loan and its purpose

This clause will contain the bank's commitment to make the loan and, again, will be in standard banking terms. It is normal to provide (assuming it to be the case) that the loan is to be used to assist the borrower in financing (or refinancing) part of the purchase price of the vessel(s), though with a proviso that the bank is not obliged to ensure that the loan is actually used for that purpose. This leaves the bank treading a tightrope – since it wants to be sure that the loan is used for the proper purpose and certainly does not want to find its right to repayment compromised by any argument (however spurious) that it knew all along that the loan was intended for something different.

3 Conditions precedent and subsequent

Before being committed to advancing the loan the lender will normally look for a large amount of information and a large number of documents to be made available in form and substance satisfactory to the lender and its lawyers. These will include the following.

proceedings in the courts of other contracting states if assets of the borrowers can be traced to those states. Prior to 1 March 2002, where matters of jurisdiction between Member States of the European Convention were governed by Article 17 of the 1968 Convention, there was a loophole for lenders, providing that if an agreement conferring jurisdiction is concluded for the benefit of only one of the parties to the contract, that party retains the right to commence proceedings against the other in any other court that would have jurisdiction by virtue of the convention. However, this wording has not been retained in the 2001 Regulation. It does apply to the states listed above which are still governed by the Brussels Convention and Lugano Convention.

As a result, therefore, most jurisdiction clauses in loan agreements and security documents will expressly stipulate that the choice of jurisdiction is made for the benefit of the lender. Although, on a very strict construction of the words of Article 17, a jurisdiction clause for the benefit of more than one party to a contract (for example, a syndicate of banks) would not come within the exception in Article 17, it is generally accepted that the Article 17 exception will apply to a jurisdiction clause for the benefit of a number (though presumably not all) of the parties to a multipartite contract.[5]

A well-drafted submission clause will contain an express waiver by the borrower of any right to claim that the action has been commenced in an inconvenient or inappropriate court,[6] and, importantly, will designate an address in England or Wales where process can be served. If no address for service is designated, the lender will need the permission of the court to serve proceedings out of the jurisdiction.[7] Although this will almost invariably be granted where the defendant has submitted to the jurisdiction, applying for permission adds unnecessary cost and delay both in making the application and in then effecting service, particularly if the borrower is being evasive.

Loan agreement provisions of particular significance

It is perhaps instructive to consider the following sample contents page from a fairly standard simple shipping term loan agreement.

Clause	Heading
1	Definitions and interpretation
2	The loan and its purpose
3	Conditions precedent and subsequent
4	Representations and warranties
5	Repayment and prepayment
6	Interest
7	Flag
8	Fees
9	Security documents
10	Covenants
11	Events of default
12	Set-off and lien

(Continued)

official certificate or transcript of registry prior to drawdown, but it is the last-minute search that is all important.

- Evidence that the vessel is (or will be from delivery) satisfactorily insured. This will normally take the form of written confirmations from the brokers or insurers summarising the principal terms of cover, most notably insured values and deductibles. Due to the complexity of insurance arrangements, lenders very regularly wish to have this confirmation reviewed before drawdown by outside insurance consultants.[13]
- A recent certificate of confirmation of class for the vessel, free of recommendations affecting class.
- Copies of the vessel's current safety construction, safety radio, safety equipment and load line certificates and any other certificates required depending on the type of vessel.
- A copy of any charterparty of the vessel. This is particularly important if the lender is looking to a long-term charterparty as the primary source of repayment and is essential if the lender is taking a specific assignment of the charterparty.[14]
- A survey report on the condition of the vessel and/or a valuation of the vessel by an independent surveyor or valuer.
- If the vessel is to be registered under a new flag, a deletion certificate from the vessel's old flag, or (if acceptable to the registration authorities of the new flag) an undertaking to provide a deletion certificate within a set period of time.
- An export licence for the vessel, if required.
- Confirmation that all legal opinions which the bank requires will be given in the form required.[15]
- All necessary bank mandates and drawdown notices.

This list is by no means exhaustive. Other conditions precedent may be called for in any particular transaction. The bank will also require any commitment or other front-end fees to be paid before advancing any funds.

This clause will probably also commit the borrower to produce to the bank as soon as practicable after drawdown evidence of registration of the bank's mortgage, evidence of any registrations required at companies or other public registries and appropriate letters of undertaking[16] from the vessel's insurers.

4 Representations and warranties

Most of these will be standard representations and warranties found in normal corporate term loan agreements, for example, as to the borrower's corporate status, absence of any insolvency proceedings and so on. Any representations and warranties specifically relating to the vessel will normally be contained in the mortgage or deed of covenants,[17] although the loan agreement will often contain a warranty that the bank has been provided with a full copy of documentation relating to the purchase and chartering of the vessel.

5 Repayment and prepayment

Repayment has been discussed in general terms above and, apart from taking into account the matters mentioned there, the fact that the loan is a shipping loan will have no effect on the

- The constitutional documents (that is, certificate of incorporation and memorandum and articles of association or equivalent) of the borrower and of any corporate guarantor. This is to ensure that the borrower has the corporate power to own the vessel, grant security over it and borrow money, and to enable the bank to see any restrictions on the powers of the directors. This is particularly important in the context of guarantees by companies incorporated in some parts of the UK.[9] There is an argument for United Kingdom companies, based on Section 35(1) of the Companies Act 1985,[10] that a third party, such as a lending bank, need no longer be concerned with the company's constitutional documents, but the drafting of the section is ambiguous[11] and generally accepted best practice remains to check.
- A certificate of goodstanding for the borrower and any corporate guarantor, if available in their country of incorporation.[12] This will confirm that no steps are being taken to wind up the borrower (or guarantor) and will confirm the payment of all outstanding corporate fees.
- A company search against the borrower and any corporate guarantor, if available in their country of incorporation, to confirm the identity of shareholders (if required to be registered) and directors, and, again, to verify that no steps have been taken to lead to the winding up or receivership or administration of the company. The extent of the information available from such a search can vary markedly depending on the county of incorporation.
- Minutes of meetings of the directors and, possibly, shareholders of the borrower and of any corporate guarantor. Precisely what is required will depend on the country of incorporation and the constitutional documents of the company, and it is essential to take local advice as to the precise requirements and any necessary formalities. For example, an English company will not normally need shareholder approval to buy or sell ships (subject always to the contents of its memorandum and articles of association); a Liberian company will generally require shareholder approval of the disposal of a substantial part of its assets or for the giving of a guarantee, and it is generally accepted practice to require shareholders' resolutions to be produced for the purchase and financing of ships, although for practical reasons this cannot be readily satisfied for a publicly traded company. It is important to ensure that any required waivers of notice of meetings or consents to short notice are also produced.
- Any powers of attorney under which the loan agreement or any other relevant documents are to be executed. Most foreign companies execute deeds (such as ship mortgages) by attorney. Again, it is imperative to take local advice as to precise requirements, both substantive and formal.
- A copy, perhaps certified by an officer of the borrower, of the memorandum of agreement by which the borrower agrees to buy the vessel; for newbuildings this will be a copy of the shipbuilding contract, together (usually) with the original refund guarantees granted to the shipowner, which will be assigned to the financing bank.
- A copy of the bill of sale transferring title in the vessel to the borrower.
- The result of a search at the relevant ship's registry confirming that the vessel is owned by the seller (or, in the case of a refinancing, the borrower) free of registered encumbrances. This search should be carried out at the last possible moment, as nearly as possible simultaneously with drawdown of the loan. The lender may also wish to be supplied with an